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### Via Electronic Mail

Office of the Executive Secretary Nevada Gaming Commission 1919 College Parkway P.O. Box 8003 Carson City, NV 89702 Fax 775-687-8221 afralick@gcb.nv.gov

Re: COMMENTS ON ISSUES RELATING TO THE OFFERING OF REBATES ON PARI-MUTUEL WAGERS

#### To Whom it May Concern:

I represent the Nevada Pari-Mutuel Association ("NPMA"). The Nevada Pari-Mutuel Association is a Nevada non-profit corporation comprising 83 race books licensed to conduct pari-mutuel wagering in Nevada and represents the interests of its members in regulatory and public affairs. This letter responds to the Nevada Gaming Commission's ("Commission") request for initial comments regarding the offering of rebates, 1 or similar incentives, on pari-mutuel wagers to aid the Commission's study and review of the issue as required by Section 3.5 of Senate Bill 425 of the 77th Legislative Session. We intend to provide more detailed evidence and testimony at the scheduled Commission hearing.

Let me first start with a historical perspective of horse racing and rebates because of its importance to understanding the issue.

Horse race wagering in Nevada has always been a tightly regulated activity both for oversight and price regulation. This is because the industry depends on others for the product—Nevada has essentially no in-state horse racing<sup>2</sup>—and for the delivery of that product by wire and television into Nevada. Virtually every aspect of the industry is price controlled. Our books must adhere to the same commission schedule as the track. This is about 19.5% of each wager. Each book must pay the same fee to the track, typically about 4.01% on each wager. It also pays

<sup>&</sup>lt;sup>1</sup> A rebate is a cash reward paid on every wager a player makes, win or lose. The amount of the reward can vary based on several factors, including bet type.

<sup>&</sup>lt;sup>2</sup> The Elko County Fair does include seven days of horse racing.



the same fees to others such as Las Vegas Dissemination Service, the monopoly provider of hub services. What little remains of the 19.5% after paying track fees, dissemination fees, employee costs and other expenses is the book's gross profit.

Rebates occur when a portion of the 19.5% is returned to the player. These are most associated with electronic clearing houses with low overhead because they do not have the employee and facility costs associated with a physical race book. If the race wagers were simply a commodity, it would be the equivalent of Amazon.com to the neighborhood book store.

The history of the prohibition against rebates in Nevada dates to 1996. At that time, the California racetracks refused to enter into an agreement with the Nevada race books to allow either common pari-mutuel pooling or simulcasting of their races because Nevada permitted rebates on their races. The Nevada books offering rebates resulted in players from California coming to Nevada to place bets on California races rather than going to the tracks. This made no economic sense to California. Why should they permit Nevada race books to offer their races when all we were doing was cannibalizing their patrons? California therefore initiated a blackout of any California races being shown in the State of Nevada that decimated our revenues.

The Nevada Legislature ultimately broke that deadlock after seven months by passing Nevada Revised Statute ("NRS") 464.075, which prohibited rebates unless permitted by regulation adopted by the Commission.<sup>3</sup> NRS 464.075(4) provides that the Commission may, by regulation, exempt certain bets, refunds, rebates, payoffs or bonuses from section 464.075(1) if the Commission determines such exemptions are in the best interests of Nevada and licensed

<sup>&</sup>lt;sup>3</sup> NRS 464.075 Altering value of wager for patron prohibited; regulations; exemptions.

<sup>1.</sup> Except as otherwise provided in subsection 4, a person who is licensed to engage in off-track pari-mutuel wagering shall not:

<sup>(</sup>a) Accept from a patron less than the full face value of an off-track pari-mutuel wager;

<sup>(</sup>b) Agree to refund or rebate to a patron any portion or percentage of the full face value of an off-track parimutuel wager; or

<sup>(</sup>c) Increase the payoff of, or pay a bonus on, a winning off-track pari-mutuel wager.

<sup>2.</sup> A person who is licensed to engage in off-track pari-mutuel wagering and who:

<sup>(</sup>a) Attempts to evade the provisions of subsection 1 by offering to a patron a wager that is not posted and offered to all patrons; or

<sup>(</sup>b) Otherwise violates the provisions of subsection 1,

is subject to the investigatory and disciplinary proceedings that are set forth in NRS 463.310 to 463.318, inclusive, and shall be punished as provided in those sections.

<sup>3.</sup> The Nevada Gaming Commission shall adopt regulations to carry out the provisions of subsections 1 and 2 of this section.

<sup>4.</sup> The Nevada Gaming Commission may, by regulation, exempt certain bets, refunds, rebates, payoffs or bonuses from the provisions of subsection 1 if the Commission determines that such exemptions are in the best interests of the State of Nevada and licensed gaming in this state. Any bets, refunds, rebates, payoffs or bonuses that would result in the amount of such bets, refunds, rebates, payoffs or bonuses being directly or indirectly deductible from gross revenue may not be exempt.

(Emphasis added).



gaming in this state. This law provided enough assurance that California permitted their races to go live again in Nevada.

The Nevada Legislature has now instructed the Commission to study and review issues relating to the offering of rebates, or similar incentives, on pari-mutuel wagers in consideration of adopting regulations under NRS 464.075(4). As part of this process, the Commission has sought public comment and concerns from the industry regarding rebates.

Rebates are controversial because large computer bettors will place their wagers with the off-track betting ("OTB") facility that gives the largest rebates. This naturally draws the players away from the track. Track attendance has plummeted. To make up for the lost track revenues, tracks are charging higher simulcast fees and imposing source market fees on ADW rebate wagers providers. A source market fees requires the OTB to pay extra for players located in the same state or geographic location of the track. These higher fees further reduce the already limited revenues for race books and negate the benefits of the increased handle that might accompany rebates.

This presumes tracks are even willing to enter into an agreement with Nevada race books if rebates are again offered. As noted above, in 1996, California tracks shut off the television signal to Nevada for seven months until we agreed not to give rebates. No assurances can be given that rebates will not be an issue in future contracts with out-of-state tracks—as it was with California—or that an out-of-state track will not again shut off the television signal to Nevada if rebates are considered.

Rebates therefore need to be explored from many perspectives.

# Rebates will cause rates our books pay to out of state tracks to escalate.

The NPMA has made inquiries to representatives of the major racetracks to determine what the likely increase would be in simulcast fees and/or simulcast market fees if rebates were authorized and the prohibition of rebate language and prohibition of account wagering language were removed from the contracts. Assuming that out-of-state track will not again shut off the television signal to Nevada but will continue to provide it, the NPMA has been advised the host fee/track fee for rebate ADW wagers would be 7-9%, an increase of 3-4% for these wagers. The NPMA also has been advised that a source market fee of 5% on ADW rebate wagers taken from residents of California and New York would be implemented.

Among the largest groups of race tracks that negotiate with the NPMA is Churchill Downs. Churchill Downs, like many of the other larger groups, has its own ADW company, i.e., Twin Spires. These groups would likely demand a high simulcast fee to prevent Nevada race books from competing with them in the ADW rebate market, thereby, further raising costs for Nevada race books if rebates, or similar incentives, are authorized.



#### Nevada race books cannot compete with rebate houses.

Even if rebates are permitted and regulated, the NPMA does not believe Nevada race books could successfully compete with the rebate houses. Rebate houses operate on margins as low as 1% and pay the rest of the amounts they receive as "hold" from the track back to the track as a simulcast fee and/or host fee and as a rebate to the player. This is due, in part, on such rebate houses operating with much less regulatory and other overhead items, which Nevada sports book cannot eliminate.

Besides having higher regulatory costs, virtually every aspect of the Nevada race book service is price controlled. Our books must adhere to the same commission schedule as the track, which is about 19.5% of each wager. Each book must pay the same fee to the track, typically about 4.01% of each wager. It also pays the same fees to others such as Las Vegas Dissemination Service, the monopoly provider of hub services. Nevada race books therefore do not control their revenue and costs and thus do not control their profits. Further hindering our ability to compete with rebate houses is the inability to deduct the amounts paid as rebates from the gross gaming revenue generated from the race wagering.

Compare this to ADW's that have no bricks and mortar components, limited regulation and a "tax" in Oregon for those who are licensed there of only .25% of the handle (in contrast, assuming Nevada race books hold 19.5% of the wagers made, our "tax" is around 1.31% of the handle—or about five times that of Oregon), it is apparent that Nevada race books have an inherent economic disadvantage that eliminates any ability to realistically compete with rebate houses.

## Rebates will change the fundamental nature of the industry.

Historically, the market for Nevada race books is tourists and some locals—the traditional horse players that love the sport. Nevada offers these race books for the convenience of its players. The industry does not make a lot of money off of its books. In fact, the average win per book is small. The average book in Nevada won over \$1.2 million in 2005. Last year that number tumbled to under \$700,000.

Let's suppose you are an <u>average book</u>, and you now have \$691,000 in gross win and about \$641,000 <u>annually</u> after paying your gaming taxes. You still must pay, among other things, your: Employees - race book manager, writers, and others; Track Fees; Systems Operator Fees; Fixed Wire Fees; Equipment Charges - terminals, printers, large screen televisions, electronic boards, wallboards; and Comps. This is not a segment of the industry flush with cash or a healthy bottom line but operates on a thin margin. Both the NPMA and the operators know this.

The NPMA and the operators also know when patrons come to Nevada, they want to have an entertainment experience when they bet on sports and horses. This experience makes them stay longer, spend more money in other parts of the casino and return more often.



Accordingly, Nevada has the most modern race books in the world with the best amenities, e.g., big screen TVs, nice chairs, individual monitors, food and beverage services, etc. In short, Nevada race books cater to flesh and blood patrons (called tourists).

Rebates, in contrast, serve a different purpose. Rebates exist to aid Computerized Robotic Wagering ("CRW"). The term CRW was invented in the U.S. horse racing market to describe people who use software and sophisticated algorithms to analyze pools and odds to find mispriced bets and place multiple, direct bets into the tote system immediately prior to a race.

A dichotomy of interests exist between CRW players and flesh and blood patrons. CRW players do not care about the customer experience nor do they care about our tourists. CRW players do not even need a physical book. They just need a place to bet and which provides the best rebates so they can lower their margins. Because computer-driven betting is mostly about covering a high percentage of combinations, the margins are small. For instance, Rob Terry, vice president of Racing and Gaming Services, a CRW company, told horsemen at a conference last year that the company lost 6% in 2011 not factoring in the track discounts. Essentially, CRW is looking to come out ahead by receiving rebates that exceed the 6%.

For Nevada race books to compete in the rebate arena, they must transform themselves from books that cater to tourists to ones that handle large volumes via remote CRW. This changes the nature of what we have been doing in Nevada and will eliminate the customer experience for in-person patrons in most casinos. If the margins shrink further because of rebates moving some customers to the rebate providers many casinos must close their books. Nevada race books will no longer cater to in-person patrons but out-of-state CRW.

Moreover, because computer teams wager such high volumes, they believe they should be heavily compensated by rebates. Many OTB operators have obliged by giving high-volume CRW teams what amounts to be significant rebates. Specifically, since these CRW teams operate as their own Advance Deposit Wagering outfits, the rebate comes in the form of a lower "host fee" for taking the track's signal. For Nevada race books to compete against tracks that deal directly with CRW teams, the books will have to offer very lucrative rebates. Better rebates for CRW, however, equals increased costs for Nevada race books.

Rebates in Nevada therefore may make it economically feasible for only two or three books to survive instead of the 83 now functioning. For Nevada race books to offset the increased costs associated with offering rebates, a large handle is necessary to spread out the costs associated with the rebates and higher fees, e.g., simulcast fees. Smaller race books, including those used by some casinos as a player convenience, do not have a large enough handle and cannot endure these increased costs. This will cause the closure of such books and the heavy loss of jobs.

The Nevada race book industry will therefore be forced to move away from the smaller, amenity and customer service based approach to a model where patrons are left only with one or two large books to choose between. This few remaining books will be large companies that have



huge amounts of volume. Their focus, however, will no longer be the in-person customer experience. Rather, to compete with out-of-state tracks and rebate houses, they will have to focus on cutting costs and streamlining their amenities to offer the best rebates to CRW play.

Ultimately, the question that has to be answered is what is better for Nevada? Many smaller books that employ numerous people and cater to our current patrons—tourists—or large consolidated books that focus on CRW play. If we want to alienate our current patrons and consolidate the industry down to one or two books that serve CRW play, then the move towards rebates is the road we should go down.

# Higher rates caused by offering rebates will cause lower overall revenues to the Nevada books.

Projections indicate that even a substantial increase in Nevada's handle stemming from offering rebates would be offset by increased expenses attributable to the aforementioned increase in track fees and rebates that would have to be given to players. The attached exhibit ("Exhibit A") demonstrates that even if the existing Nevada handle (about \$325 million) was to hypothetically expand to 800 million, which is almost two and a half times the current handle, the increased expenses resulting from higher track fees and issuing rebates simultaneously negates any increase in revenue for the race books. In fact, Nevada race books will suffer 12.68% decrease in gross margin.

Moreover, the belief that such a radical expansion of the Nevada handle could even occur is highly unlikely given the current state of the horse racing industry. Over the last decade, the national handle has plummeted 28.3 percent, from \$15.18 billion to \$10.88 billion, according to The Jockey Club numbers.<sup>4</sup> There simply are not enough players in the marketplace to sufficiently increase our handle to make the offering of rebates profitable.

Finally, even if a sufficient player pool did exist, such a drastic expansion will not happen under current Nevada law because, as detailed throughout, the electronic high volume ADWs do not have to pay Nevada gross revenue taxes on the rebates or the high fees paid the dissemination company. Our books will not be able to compete on price against these ADWs.

# Shifting focus from tourists to rebate players introduces different set of regulatory problems.

If the decision is made to move away from tourists to rebate players, the industry will be facing a different set of regulatory challenges, most notably, scrutiny of CRW teams, money laundering and skimming concerns.

In January of 2005, many of the industry's concerns with rebate shops came to the forefront in the Uvari indictment. Several individuals, allegedly associated with the Gambino

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<sup>&</sup>lt;sup>4</sup> See <a href="http://www.jockeyclub.com/factbook.asp?section=8">http://www.jockeyclub.com/factbook.asp?section=8</a>.



crime family,<sup>5</sup> (the "Uvari Group") used certain rebate shops to operate an illegal gambling business that brokered more than \$200 million in bets on horse racing and other sporting events. According to the Indictment, the Uvari Group typically made money on every bet placed by one of its bettors at an off-site gambling business. The amount of this "commission," or "rebate," was allegedly negotiated by the Uvari Group based on the number of accounts that the Uvari Group opened at the off-site gambling business and represented a percentage of the bet that the Uvari Group received regardless of whether the bettor won or lost. For each bet, the Uvari Group allegedly returned a portion of its commission or rebate to the bettor, as an incentive for the bettor to continue to place bets through the Uvari Group. The Uvari group also concealed the identities of most gamblers in its operation thereby promoting tax fraud and also allegedly engaged in money laundering.

Based on the Uvari indictment, the New York Racing Association – and for a time the New York Racing and Wagering Board – decided that offshore rebators had significant potential for money laundering and stopped doing business with these offshore firms. The end result today is even stricter regulatory control from states. Due diligence programs are being used that look into the ownership and business operations of CRW teams wagering into pari-mutuel pools. Regarding New York, players receiving rebates from Nevada books would likely have to be disclosed to the New York regulators and additional investigation regarding those players could be required.

An additional regulatory challenge stemming from the use of rebates is the unlawful compensation of persons who have not been approved by the Nevada Gaming Commission, as required under NRS 464.025(2). A recent example of this issue was uncovered in 2006 by the Nevada Gaming Control Board ("Board") during its investigation of the Poker Palace. The Board's investigation revealed that the Poker Place had engaged several unlicensed bookmakers by offering an off-track pari-mutuel contest, which effectively guaranteed the bookmakers a rebate on their wagering activity. The contest prize pool consisted of the total contest entry fees plus a percentage of the off-track pari-mutuel handle for the previous week. However, the contest was only held if the prior week's off-track pari-mutuel handle exceeded \$200,000, which was the minimum wagering activity the unlicensed bookmakers had agreed to conduct at the Poker Palace.

Throughout the time period in which the contest was held, there were rarely more than four participants and, with few exceptions, every participant was associated with the unlicensed

<sup>&</sup>lt;sup>5</sup> *See* http://www.usdoj.gov/usao/nys/pressreleases/January05/uvarietalindictmentpr.pdf.

<sup>&</sup>lt;sup>6</sup> See NGC Case No. 08-17 Complaint, p.7 (May 12, 2009).

<sup>&</sup>lt;sup>7</sup> See Id. at 7-9. Historical data indicated that the handle for the Poker Palace's off-track pari-mutuel wagering operation averaged around \$100,000 per month, far below the weekly amount of wagers the unlicensed bookmakers were required to place.



bookmakers.<sup>8</sup> Because each contest provided four prizes, most of the contests resulted in each unlicensed bookmaker receiving a portion of the prize pool.<sup>9</sup> Although the contest was designed to appear legitimate on its face, the manner in which the contest was conducted and the make-up of the cash-prize pool rendered it nothing more than a front for an unlawful rebate scheme in violation of NRS 464.075(1)(b) and NGC Reg. 22.125(1)(b).<sup>10</sup> The issue is illustrative, however, of the use of rebates as a vehicle to accomplish an unlawful activity, e.g., providing illegal compensation incentives. In the absence of sufficient regulations, ostensibly lawful rebates may be designed to disguise other illegal activities.

# Rebates can be a tool for predatory pricing.

As noted earlier, Nevada race books must rely on others for the product and for the delivery of that product by wire and television into Nevada. This requires our industry to enter into numerous price controlled contracts. For instance, we have to contract with the tracks to place our wagers into its pools (called track fees), we need contracts for communications and telecasting of the races and we need contracts for the hub services (called hub fees).

The Nevada Gaming Commission has therefore appointed an eleven person committee, representing eleven licensed pari-mutuel books, that has the exclusive right to negotiate these agreements with the tracks and with the systems operator. When the committee agrees to a rate with either a track or the systems operator, the rate must be "fair and equitable" for all books in the state. The track fees are the same for every book. If the books pay a daily fee to the track as opposed to a percentage fee, books pay a percentage based on their percentage of the handle on that track. So, if the daily fee is \$500 and a book has 10% of the total handle on that track, then that book pays \$50. If it has 1%, it pays \$5.

These fees are paid out from a race book's commission on wagers, also referred to as the takeout.<sup>11</sup> The money left over from the takeout after paying the track fees, hub fees, gaming taxes and all operating expenses is the net revenue of the book. What little revenue left, is a book's small profit margin.

Therefore, a race book that wished to engage in predatory pricing could easily use unregulated rebates to price everyone else out of the industry. Because race books cannot increase their margins as fees are price controlled and revenue percentages are fixed, <sup>12</sup> offering

<sup>&</sup>lt;sup>8</sup> *See Id.* at p.7.

<sup>&</sup>lt;sup>9</sup> See Id.

<sup>10</sup> See Id.

<sup>11</sup> Takeout means "the amount retained and not returned to patrons by a pari-mutuel book from the total amount of off-track pari-mutuel wagers." NGC Reg. 26A.020(4).

<sup>&</sup>lt;sup>12</sup> NGC Reg. 26A.150 Deduction of commission on wagers. The total percentage of off-track pari-mutuel wagers that is to be deducted as a commission on wagers must be:

<sup>1.</sup> For interstate common pari-mutuel pools, the same percentage as deducted by the track, unless a different percentage is otherwise approved by the commission; and



lucrative rebates will likely eliminate the competition. Again, books with smaller handles simply can not absorb the added costs stemming from offering rebates given their already slim profits and will have to close.

### **Summary**

The preceding are not the only potential issues that may arise from shifting the focus of race books from tourists to rebate players. Rebates may lead to other problems such as money laundering and skimming in casinos. Accordingly, new and sophisticated due diligence programs will have to be instituted to ensure the integrity of the wagers made and rebates received via Nevada race books. At a minimum, rebates need to be regulated so they are not abused as a method to return 100% of the wager in "clean" winnings.

The offering of rebates poses serious concern to the NPMA. Most notably, the NPMA does not believe permitting rebates would allow Nevada race books, as they exist today, to continue. Rather, even with an extremely significant increase in Nevada's handle, which is improbable, the increased fees and costs associated with the rebates reflect a substantial increase in cost to do business for Nevada race books and will likely result in decreased profits. The Nevada race book industry will therefore probably be forced to move away from the smaller, amenity and customer service based approach to a model where patrons are left only with one or two large books to choose between that cater to out-of-state CRW play. The NPMA does not believe this would not be in the best interests of Nevada and licensed gaming in the state as required in subsection 4 of NRS § 464.075.

I hope this brief letter is helpful in demonstrating the issues and our concerns relating to the offering of rebates, or similar incentives, on pari-mutuel wagers. Please contact me, if you have any questions regarding the preceding.

Sincerely,

LEWIS AND ROCA LLP

Anthony Cabot

ANC/kr

**Enclosures** 

cc: Patty Jones, Executive Director of the NPMA (w/Encls.)

<sup>2.</sup> For intrastate common pari-mutuel pools, a percentage not to exceed 25 percent.